

Notice of Proposed Regulatory Action
The State Board of Equalization Proposes to Adopt
Amendments to California Code of Regulations, Title 18,
Section 1685.5, *Calculation of Estimated Use Tax - Use Tax Table*

NOTICE IS HEREBY GIVEN

The State Board of Equalization (Board), pursuant to the authority vested in it by Revenue and Taxation Code (RTC) section 7051, proposes to adopt amendments to California Code of Regulations, title 18, section (Regulation) 1685.5, *Calculation of Estimated Use Tax - Use Tax Table*. Regulation 1685.5 prescribes the manner in which the Board “shall annually calculate the estimated amount of use tax due according to a person’s adjusted gross income and by July 30 of each calendar year make available to [the] Franchise Tax Board such amounts in the form of a use tax table,” as required by RTC section 6452.1. The proposed amendments update the manner in which the Board shall annually calculate the estimated amount of use tax due according to a person’s adjusted gross income (AGI) for calendar year 2013 and subsequent years to account for the expanded use tax registration requirements imposed by Assembly Bill No. (AB) 155 (Stats. 2011, ch. 313) and recent registration activities.

PUBLIC HEARING

The Board will conduct a meeting in Room 207, 5901 Green Valley Circle, Culver City, California, on April 24-26, 2013. The Board will provide notice of the meeting to any person who requests that notice in writing and make the notice, including the specific agenda for the meeting, available on the Board’s Website at www.boe.ca.gov at least 10 days in advance of the meeting.

A public hearing regarding the proposed regulatory action will be held at 9:30 a.m. or as soon thereafter as the matter may be heard on April 24, 25, or 26, 2013. At the hearing, any interested person may present or submit oral or written statements, arguments, or contentions regarding the adoption of the proposed amendments to Regulation 1685.5.

AUTHORITY

RTC section 7051.

REFERENCE

RTC section 6452.1.

INFORMATIVE DIGEST/POLICY STATEMENT OVERVIEW

Current Law

Under RTC sections 6202 and 6453, consumers are primarily liable for reporting and paying use tax imposed on the storage, use, or other consumption of tangible personal property in this state. However, under RTC sections 6203, 6226, and 6453, specified retailers are required to register with the Board, collect use tax from their California customers, and report and pay the use tax to the state. Therefore, under Regulation 1685, *Payment of Tax by Purchasers*, consumers are required to report and pay their own use taxes to the state when they purchase tangible personal property for storage, use, or other consumption in this state from unregistered retailers that do not collect California use tax.

Prior to 2010, consumers could only report and pay their use taxes to the Board. However, RTC section 6452.1 was enacted in 2010 to make it more convenient for consumers to comply with their use tax obligations by permitting consumers to make an irrevocable election to report “qualified use tax” on an “acceptable [income] tax return” filed with the Franchise Tax Board (FTB). RTC section 6452.1, subdivision (d)(2), as enacted by Statutes 2010, chapter 721, defined the term “qualified use tax” to mean a taxpayer’s actual unpaid use tax liability after applying the state use taxes imposed under the Sales and Use Tax Law (RTC § 6001 et seq.) and article XIII of the California Constitution, and the local and district use taxes imposed in conformity with the Bradley-Burns Uniform Local Sales and Use Tax Law (RTC § 7200 et seq.) or in accordance with the Transactions and Use Tax Law (RTC § 7251 et seq.) to the taxpayer’s purchases of tangible personal property subject to use tax.

Senate Bill No. (SB) 86 (Stats. 2011, ch. 14) amended RTC section 6452.1 to make it more convenient for taxpayers to comply with their use tax obligations by giving taxpayers the option to report their “estimated use tax liabilities,” based upon their AGIs for income tax purposes, for one or more single nonbusiness purchases of individual items of tangible personal property each with a sales price of less than one thousand dollars (\$1000), as determined from a use tax table, on their income tax returns, instead of calculating and reporting their actual unpaid use tax liabilities (as described above). In addition, RTC section 6452.1, subdivision (d)(2)(A)(i)(II), as amended by SB 86, requires the Board to “annually calculate the estimated amount of use tax due according to a person’s adjusted gross income and by July 30 of each calendar year make available to [the] Franchise Tax Board such amounts in the form of a use tax table” for inclusion in the instructions to the FTB’s returns and use by eligible taxpayers.

The Board adopted Regulation 1685.5 on July 26, 2011, to prescribe the specific use tax table that taxpayers could use to estimate their calendar-year 2011 use taxes based upon their AGIs, prescribe the manner in which the Board shall annually calculate the estimated amount of use tax due according to a person’s AGI for calendar-year 2012 and subsequent years, and prescribe the format of the use tax tables the Board would be required to make available to the FTB for calendar-year 2012 and subsequent years. After discussing Regulation 1685.5 with interested parties, the Board adopted amendments to Regulation 1685.5 on March 20, 2012, to update the manner in which the Board annually calculates the estimated amount of use tax due according to a person’s AGI and makes such amounts available to the FTB in the form of a use tax table for

calendar-year 2012 and subsequent years. The Notice of Action for the 2012 amendments explained that:

The proposed [2012] amendments to Regulation 1685.5, subdivision (b)(2), will require that the Board multiply the percentage of income spent on taxable purchases during the preceding year by 0.37, which represents the estimated percentage of California consumers' total purchases of tangible personal property for use in California from all out-of-state retailers that are made from out-of-state retailers that are not registered with the Board to collect use tax from their customers. AB 155 (Stats. 2011, ch. 313) expanded the use tax registration requirements so that they apply to some out-of-state retailers, including Internet retailers, that were previously not required to register with the Board to collect and remit use tax on their sales of tangible personal property to California customers. However, section 6 of AB 155 provides that the new registration requirements will not be operative until either September 15, 2012, or January 1, 2013, and the Board is currently unable to determine whether the new registration requirements will reduce the percentage of California consumers' total purchases of tangible personal property for use in California from all out-of-state retailers that are made from out-of-state retailers that are not registered with the Board to collect use tax from their customers during 2012 or in subsequent years, and, if so, the extent of such reduction. Therefore, the Board is not proposing to amend Regulation 1685.5 to account for the new registration requirements imposed by AB 155 at this time. However, the Board is continuing to monitor the implementation of AB 155 and considering whether to propose sufficiently related changes to the original text of the proposed amendments to Regulation 1685.5 to account for the enactment of AB 155 or other events that may change the percentage of taxable purchases that California consumers make from unregistered out-of-state retailers during 2012 or subsequent years.

However, the Board did not make sufficiently related changes to the text of the 2012 amendments to Regulation 1685.5 to account for the enactment of AB 155 because the Board could not determine when AB 155's expanded use tax registration requirements would be operative and could not adequately estimate the effect of the expanded use tax registration requirements when the Board adopted the 2012 amendments. Instead, the Board continued to monitor the implementation of AB 155 and consider whether to propose amendments to Regulation 1685.5 to account for the enactment of AB 155 and the expanded use tax registration requirements effect on the percentage of taxable purchases that California consumers make from unregistered out-of-state retailers during calendar-year 2013 and subsequent years.

Effect, Objectives, and Benefits of the Proposed Amendments to Regulation 1685.5

The expanded registration requirements (discussed above) became operative on September 15, 2012, in accordance with section 6, subdivision (b)(2), of AB 155. The Board did see an increase in the number of out-of-state retailers registered to collect California use tax around that time, and Board staff was subsequently able to determine that those registration activities, including the registration of some retailers that make substantial sales to California consumers, indicate that there will be an overall decrease in the percentage of taxable purchases California consumers make from unregistered out-of-state retailers during calendar-year 2013, and in subsequent years. In addition, Board staff was able to:

- Calculate adjusted total 2011 United States electronic commerce sales;
- Determine that 86.9 percent of those sales were made by the top 500 Internet retailers and 13.1 percent of those sales were made by other Internet retailers;
- Estimate that 14.4 percent of the top 500 Internet retailers and 78 percent of the other Internet retailers were not registered with the Board to collect use tax after the operative date of AB 155; and
- Arrive at a weighted average percentage of sales made by unregistered Internet retailers of 22.7 percent $((.869 \times .144) + (.131 \times .78))$.

Therefore, staff prepared a memorandum dated January 4, 2013, which recommended that “the Board amend Regulation 1685.5, subdivision (b)(2), to change the estimated percentage of California consumers’ total purchases of tangible personal property for use in California that are made from out-of-state retailers that are not registered with the Board to collect use tax from their customers from 37 percent to 23 percent to account for the new use tax registration requirements imposed by AB 155 and recent registration activities.” And, Board staff submitted the memorandum to the Board Members for their consideration at the Board’s January 15, 2013, Business Taxes Committee meeting.

During the January 15, 2013, meeting, Ms. Gina Rodriguez, Vice President of State Tax Policy for the California Taxpayers Association (CalTax), stated that CalTax supports the amendments to Regulation 1685.5 and the Board Members unanimously voted to propose their adoption. The Board determined that the amendments are reasonably necessary to account for the expanded registration requirements imposed by AB 155 operative September 15, 2012, and the recent registration activity discussed above.

The objective of the proposed amendments is to make the Board’s calculations of the estimated amount of use tax due according to a person’s AGI for calendar-year 2013 and subsequent years as accurate as possible by accounting for the expanded use tax registration requirements imposed by AB 155 and recent registration activities. The Board anticipates that the proposed amendments will promote fairness and generally encourage consumers to use the Board’s use tax tables by ensuring that eligible consumers’ estimated use tax liabilities are as accurate as possible.

The Board has performed an evaluation of whether the proposed amendments to Regulation 1685.5 are inconsistent or incompatible with existing state regulations and determined that the proposed amendments are not inconsistent or incompatible with existing state regulations because Regulation 1685.5 is the only state regulation

prescribing the manner in which the Board “shall annually calculate the estimated amount of use tax due according to a person’s adjusted gross income and by July 30 of each calendar year make available to [the] Franchise Tax Board such amounts in the form of a use tax table,” as required by RTC section 6452.1. There is no federal use tax and there are no comparable federal regulations or statutes to Regulation 1685.5.

NO MANDATE ON LOCAL AGENCIES AND SCHOOL DISTRICTS

The Board has determined that the adoption of the proposed amendments to Regulation 1685.5 will not impose a mandate on local agencies or school districts, including a mandate that is required to be reimbursed under part 7 (commencing with section 17500) of division 4 of title 2 of the Government Code.

NO COST OR SAVINGS TO STATE AGENCIES, LOCAL AGENCIES, AND SCHOOL DISTRICTS

The Board has determined that the adoption of the proposed amendments to Regulation 1685.5 will result in no direct or indirect cost or savings to any state agency, any cost to local agencies or school districts that is required to be reimbursed under part 7 (commencing with section 17500) of division 4 of title 2 of the Government Code, other non-discretionary cost or savings imposed on local agencies, or cost or savings in federal funding to the State of California.

NO SIGNIFICANT STATEWIDE ADVERSE ECONOMIC IMPACT DIRECTLY AFFECTING BUSINESS

The Board has made an initial determination that the adoption of the proposed amendments to Regulation 1685.5 will not have a significant, statewide adverse economic impact directly affecting business, including the ability of California businesses to compete with businesses in other states.

The adoption of the proposed amendments to Regulation 1685.5 may affect small business.

NO COST IMPACTS TO PRIVATE PERSONS OR BUSINESSES

The Board is not aware of any cost impacts that a representative private person or business would necessarily incur in reasonable compliance with the proposed action.

RESULTS OF THE ECONOMIC IMPACT ANALYSIS REQUIRED BY GOVERNMENT CODE SECTION 11346.3, SUBDIVISION (b)

The Board has prepared the economic impact analysis required by Government Code section 11346.3, subdivision (b)(1), and included it in the initial statement of reasons. The Board has determined that the adoption of the proposed amendments to Regulation 1685.5 will neither create nor eliminate jobs in the State of California nor result in the

elimination of existing businesses nor create or expand business in the State of California. Furthermore, the Board has determined that the adoption of the proposed amendments to Regulation 1685.5 will not affect the health and welfare of California residents, worker safety, or the state's environment.

NO SIGNIFICANT EFFECT ON HOUSING COSTS

Adoption of the proposed amendments to Regulation 1685.5 will not have a significant effect on housing costs.

DETERMINATION REGARDING ALTERNATIVES

The Board must determine that no reasonable alternative considered by it or that has been otherwise identified and brought to its attention would be more effective in carrying out the purpose for which the action is proposed, would be as effective and less burdensome to affected private persons than the proposed action, or would be more cost effective to affected private persons and equally effective in implementing the statutory policy or other provision of law than the proposed action.

CONTACT PERSONS

Questions regarding the substance of the proposed amendments should be directed to Bradley M. Heller, Tax Counsel IV, by telephone at (916) 323-3091, by e-mail at Bradley.Heller@boe.ca.gov, or by mail at State Board of Equalization, Attn: Bradley M. Heller, MIC:82, 450 N Street, P.O. Box 942879, Sacramento, CA 94279-0082.

Written comments for the Board's consideration, notice of intent to present testimony or witnesses at the public hearing, and inquiries concerning the proposed administrative action should be directed to Mr. Rick Bennion, Regulations Coordinator, by telephone at (916) 445-2130, by fax at (916) 324-3984, by e-mail at Richard.Bennion@boe.ca.gov, or by mail at State Board of Equalization, Attn: Rick Bennion, MIC:80, 450 N Street, P.O. Box 942879, Sacramento, CA 94279-0080.

WRITTEN COMMENT PERIOD

The written comment period ends at 9:30 a.m. on April 24, 2013, or as soon thereafter as the Board begins the public hearing regarding the proposed amendments to Regulation 1685.5 during the April 24-26, 2013, Board meeting. Written comments received by Mr. Rick Bennion at the postal address, email address, or fax number provided above, prior to the close of the written comment period, will be presented to the Board and the Board will consider the statements, arguments, and/or contentions contained in those written comments before the Board decides whether to adopt the proposed amendments to Regulation 1685.5. The Board will only consider written comments received by that time.

AVAILABILITY OF INITIAL STATEMENT OF REASONS AND TEXT OF PROPOSED REGULATION

The Board has prepared an underscored and strikeout version of the text of Regulation 1685.5 illustrating the express terms of the proposed amendments and an initial statement of reasons for the adoption of the proposed amendments, which includes the economic impact analysis required by Government Code section 11346.3, subdivision (b)(1). These documents and all the information on which the proposed amendments are based are available to the public upon request. The rulemaking file is available for public inspection at 450 N Street, Sacramento, California. The express terms of the proposed amendments and the initial statement of reasons are also available on the Board's Website at www.boe.ca.gov.

SUBSTANTIALLY RELATED CHANGES PURSUANT TO GOVERNMENT CODE SECTION 11346.8

The Board may adopt the proposed amendments to Regulation 1685.5 with changes that are nonsubstantial or solely grammatical in nature, or sufficiently related to the original proposed text that the public was adequately placed on notice that the changes could result from the originally proposed regulatory action. If a sufficiently related change is made, the Board will make the full text of the proposed amendments, with the change clearly indicated, available to the public for at least 15 days before adoption. The text of the resulting amendments will be mailed to those interested parties who commented on the original proposed amendments orally or in writing or who asked to be informed of such changes. The text of the resulting amendments will also be available to the public from Mr. Bennion. The Board will consider written comments on the resulting amendments that are received prior to adoption.

AVAILABILITY OF FINAL STATEMENT OF REASONS

If the Board adopts the proposed amendments to Regulation 1685.5, the Board will prepare a final statement of reasons, which will be made available for inspection at 450 N Street, Sacramento, California, and available on the Board's Website at www.boe.ca.gov.